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1992 Feature Article - Australia's Foreign Debt

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INTRODUCTION

This article examines Australia's foreign debt for the period 1975-76 to 1991-92, the period for which consistent statistics are available. During this period there were many changes in the financial sector, with the floating of the Australian dollar in 1983, changes to banking regulations in 1984, changes to foreign investment policies, further deregulation in 1985 and high interest rates at the end of the 1980s.

Selected foreign debt ratios are derived and discussed. These ratios relate foreign debt to other economic variables. This enables foreign debt to be examined in relation to the economy as a whole, leading to more meaningful historical comparisons. The changing composition of Australia's foreign debt is considered and the difficulty in making international comparisons is discussed briefly.

AUSTRALIA'S FOREIGN DEBT

Foreign debt is defined as the amount borrowed from non-residents by residents of a country. It is a subset of financial obligations that make up that country's international investment position. It is distinguished from other components of international investment by the obligation to pay interest and/or repay principal. Components of Australia's International Investment Position (IIP) excluded from foreign debt are equity investment, accounts payable/receivable and prepayments made/received.

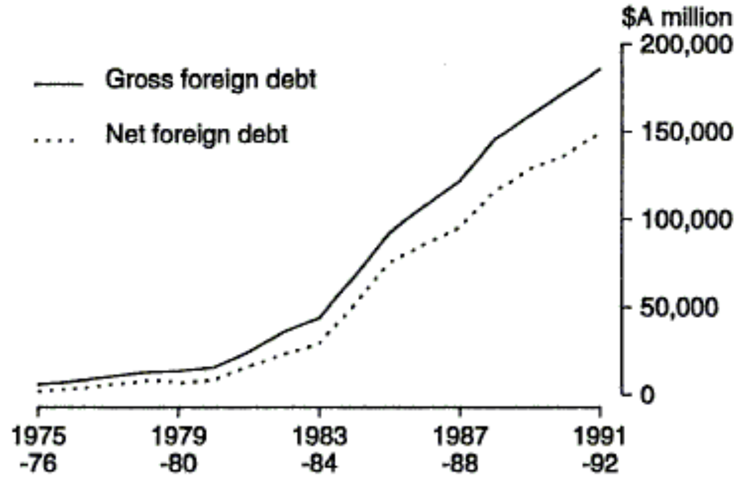
A distinction is made in Australia's statistics between gross and net foreign debt. Gross foreign debt is the total amount of borrowing from non-residents. Net foreign debt is equal to gross foreign debt minus official reserve assets and lending by residents of Australia to non-residents. Official reserve assets are held by the Reserve Bank of Australia and include monetary gold, foreign exchange holdings, special drawing rights and Australia's reserve position in the International Monetary Fund. Examples of financial obligations that are included in the categories borrowing/lending are deposits, loans, finance leases, bonds, bills, IMF credit and Bank for International Settlements placements.

Australia's net foreign debt grew at an average rate of 29.5 per cent per annum from $2,399 million at 30 June 1976 to $150,050 million at 30 June 1992.

The difference between gross and net debt has increased steadily since 1975-76. The main component of this difference is official reserve assets, although Australian financial enterprises have been lending more abroad in recent years. It is clear from Graph 1, however, that the growth

in gross foreign debt has been substantial relative to the growth in reserve assets and lending abroad. Consequently, net foreign debt has been closely tracking gross foreign debt.

GRAPH 1. FOREIGN DEBT, AT END OF YEAR



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

The components of a change in foreign debt are capital transactions (recorded on a net basis, for example, drawings less repayments); changes due to exchange rate movements; and other factors, such as changes in the market value of a claim or liability, reclassifications and reconciliation errors.

As shown in Table 1, $105,309 (88 per cent) of the change in the level of net debt during the period 30 June 1984 to 30 June 1992 was through capital transactions, while $10,491 million. (9 per cent) of the change in level of net debt was due to changes in the exchange rate.

TABLE 1. RECONCILIATION OF OPENING AND CLOSING LEVELS OF NET FOREIGN DEBT ($A MILLION)

	Opening level at 30 June	Transactions	Exchange rate	Other changes	Closing level at 30 June
1984-85	29,893	13,536	5,012	-533	51,208
1985-86	51,208	17,592	4,181	2,564	75,545
1986-87	75,545	12,203	-1,594	-16	86,138
1987-88	86,138	13,736	-3,840	-43	95,991
1988-89	95,991	17,385	1,238	1,986	116,601
1989-90	116,601	13,852	-891	-332	129,229
1990-91	129,229	4,645	1,767	1,569	137,210
1991-92	137,210	12,060	1,618	-837	150,050
Total					
1984-92	29,893	105,309	10,491	4,358	150,050

Source: cat. nos 5305.0 (annual data) & 5306.0 (quarterly data).

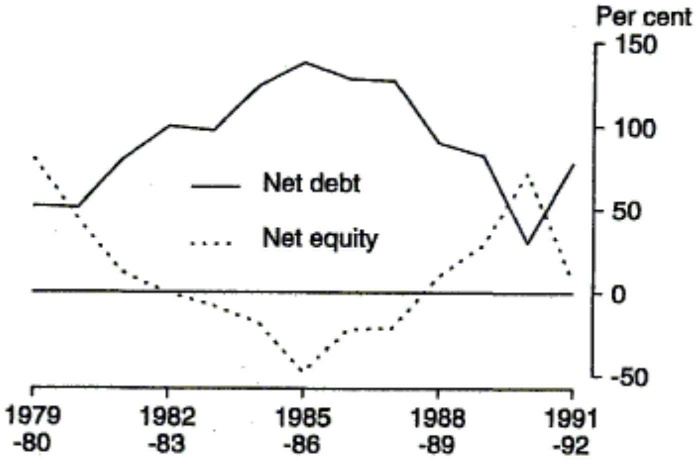
Several factors contributed to the rise in Australia’s net foreign debt over the period of observation.

- Australia had high current account deficits with the rest of the world throughout the 1980s. These deficits were financed largely by borrowing from abroad. Deregulation of financial markets, removal of exchange controls and lower interest rates overseas all acted to swing

the balance in favour of debt financing over equity, the predominant form of financing up until 1979-80.

- Rising asset prices, removal of exchange controls and other regulations and aggressive lending policies of banks also contributed to a marked expansion of Australian investment abroad, especially equity investment. Foreign borrowing funded much of this expansion. Australian equity investment abroad rose steadily, from $775 million at 30 June 1976 to $56,037 million at 30 June 1990. It fell in 1990-91 by 6 per cent to $52,640 but rose again by 10 per cent in 1991-92 to $57,705 million. Graph 2 illustrates net debt and net equity transactions as a proportion of total net capital transactions. From this graph it can be seen that there was a net capital outflow in respect of equity between 1982-83 and 1987-88. This reflects larger capital outflows in respect of Australian equity investment abroad than inflows in respect of foreign investment in Australian equity over this period. However, as a result of the share market collapse in October 1987 and rising interest (debt servicing) costs this situation began to turn around as Australian companies began selling their equity investments, both in Australia and abroad, in order to meet other financial commitments. By 1990-91 the net capital inflow in respect of equity had overtaken that in respect of net debt. This trend reversed again in 1991-92 with a resurgence in debt financing compared to equity.

GRAPH 2. NET CAPITAL TRANSACTIONS, PROPORTIONS OF TOTAL BY INSTRUMENT OF INVESTMENT



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

- The level of net foreign debt increased as a result of the decline in the exchange rate in the mid 1980s. Table 1 illustrates the contribution exchange rate changes made to the level of net foreign debt during this period. This is discussed in more detail in the section below on the composition of Australia's foreign debt.

- The size of the current account deficit and the increase in the level of net foreign debt reflect the higher cost of servicing this debt resulting from higher world interest rates. For example, in the 1970s, the yield on long-term US bonds averaged 6.7 per cent, while in the 1980s the average was 10.4 per cent, 3.7 percentage points higher. Graphs and data on both short-term and long-term interest rates are presented in the International Comparisons chapter of Australian Economic Indicators. This topic is discussed in detail in the section below on the measurement of the debt burden.

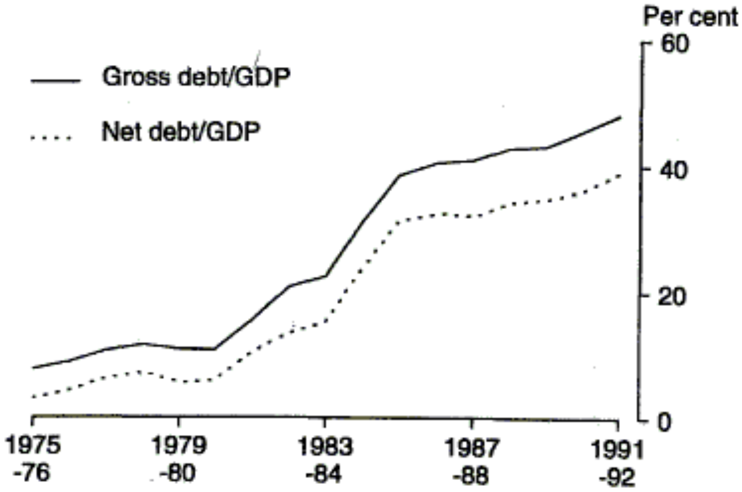
- In the 1980s Australian interest rates were higher than those prevailing overseas. The

graphs of long term and short term interest rates in the International Comparisons chapter of Australian Economic Indicators show both the higher rates in Australia in comparison to the United States, Japan, United Kingdom and Germany and the widening gap between Australia's rates and those countries' rates in the mid 1980s. As a consequence, enterprises borrowed from abroad in preference to borrowing in Australia, resulting in a rise in both foreign debt and interest payable abroad.

FOREIGN DEBT TO GDP

The comparison of the level of foreign debt with other economic variables allows a more meaningful interpretation of its significance. To place the extent of foreign debt in context and to permit more valid comparisons over time and between countries, the level of debt is often expressed as a percentage of the national accounting measure of domestic production, Gross Domestic Product (GDP). Movements in the ratio are a useful indicator of the changing significance of foreign debt.

GRAPH 3. RATIO OF FOREIGN DEBT TO GDP



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

A constant foreign debt to GDP ratio during a period when foreign debt is increasing could reflect, for example, the financing requirements of an expanding economy. As can be seen in Table 2 below, Australia's net debt ratio increased rapidly over the period 1980-81 to 1985-86, from 6.1 per cent to 31.4 per cent, as debt rose more quickly than GDP. It then increased more slowly to 39.0 per cent in 1991-92.

TABLE 2. AUSTRALIA'S NET FOREIGN DEBT AND GDP

Year ending June	Net Debt ($m)	Per cent change in Net Debt (%)	GDP ($m)	Per cent change in GDP(%)	Net Debt/GDP (per cent)
1976	2,399	na	76,643	na	3.1
1980	6,863	186	122,933	60	5.6
1981	8,663	26	140,145	14	6.1
1982	16,547	91	158,099	13	10.5
1983	23,384	41	171,706	9	13.6
1984	29,893	28	194,777	13	15.3
1985	51,208	71	216,150	10	23.7
1986	75,545	48	240,319	11	31.4
1987	86,138	14	264,564	10	32.6
1988	95,991	11	298,335	13	32.2

1989	116,601	21	340,440	14	34.3
1990	129,229	11	369,749	9	35.0
1991	137,210	6	378,413	2	36.3
1992	150,050	9	384,871	2	39.0

na = not available

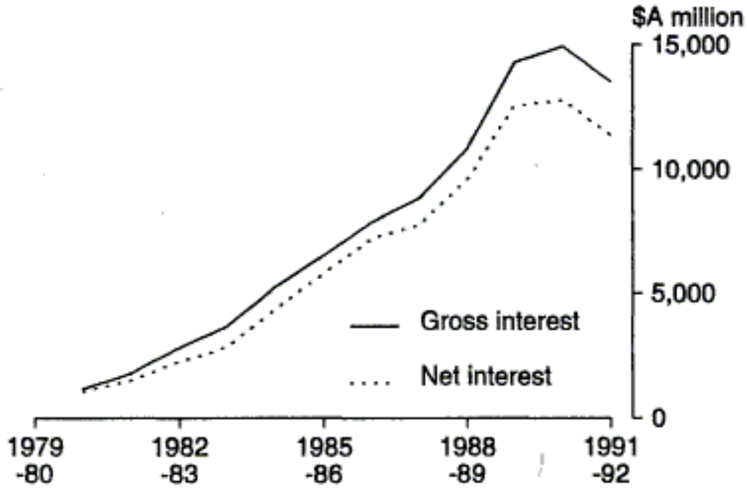
Source: cat. nos 5305.0 (annual data) & 5306.0 (quarterly data).

MEASUREMENT OF DEBT BURDEN

The existence of foreign debt involves an obligation of the domestic economy to service that debt. Interest payments on debt are an important aspect of the impact of foreign debt. The interest burden adds directly to the current account deficit. The amount of net interest payable abroad on net foreign debt increased steadily up until 1990-91 as the level of net foreign debt increased. However, in 1991-92 net interest payable abroad fell to $11,355 million, a decrease of 11 per cent, reflecting the falls in Australian and overseas interest rates.

It is important to distinguish between gross and net interest payable. Gross interest payable is income payable on foreign borrowing, while net interest payable is income payable on foreign borrowing less income receivable on Australian lending abroad and reserve assets. The gap between gross and net interest payable has been widening in recent years as income receivable on Australian lending abroad and reserve assets has grown, from $96 million in 1980-81 (estimates of interest payable on net foreign debt and other liabilities are not available separately for periods prior to 1980-81) to $2,196 million in 1991-92. However, it is clear from Graph 4 that, compared to the growth in interest receivable, the growth in interest payable on foreign borrowing was substantial. Over the same period, it rose from $1,175 million to $13,551 million, an increase of $12,376 million.

GRAPH 4. INTEREST PAYABLE ON FOREIGN BORROWING



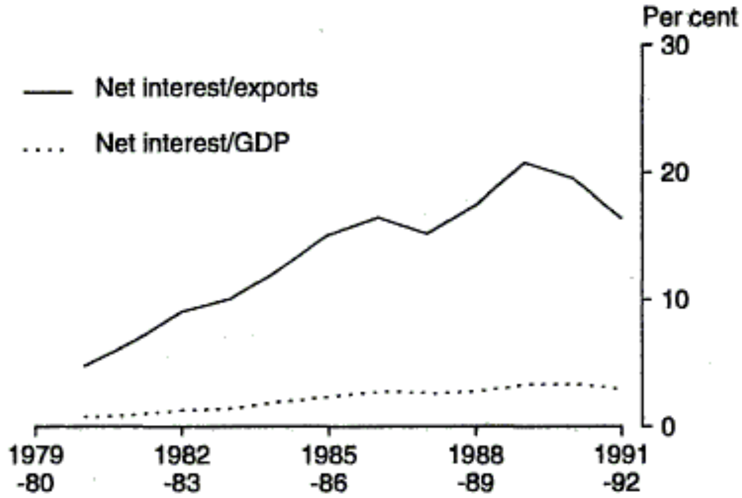
Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

Debt service ratios portray an economy's "capacity to pay" the costs associated with debt obligations. There are a number of alternative measures:

- net interest payable to GDP;
- net interest payable to exports of goods and services; and
- net interest payable to balance on the current account.

The ratio of net interest payable to GDP rose steadily, from 1.0 per cent in 1980-81, to 3.4 per cent in 1990-91. It then dropped to 2.95 per cent in 1991-92. This means that in 1991-92, net interest payable to overseas represented 2.95 per cent of the value of goods and services produced within Australia in that year. The ratio of net interest payable to exports of goods and services also trebled during this period, from 4.8 per cent in 1980-81 to 19.6 per cent in 1990-91 but dropped to 16.5 per cent in 1991-92. The ratio of net interest payable to the balance on the current account rose from 20.0 per cent in 1980-81 to 95.7 per cent in 1991-92. In other words, by 1991-92, exports of goods and services were almost sufficient to finance our imports of goods and services, so that the balance on current and capital accounts largely reflected the net income deficit and its financing, respectively.

GRAPH 5. NET INTEREST PAYABLE RATIOS

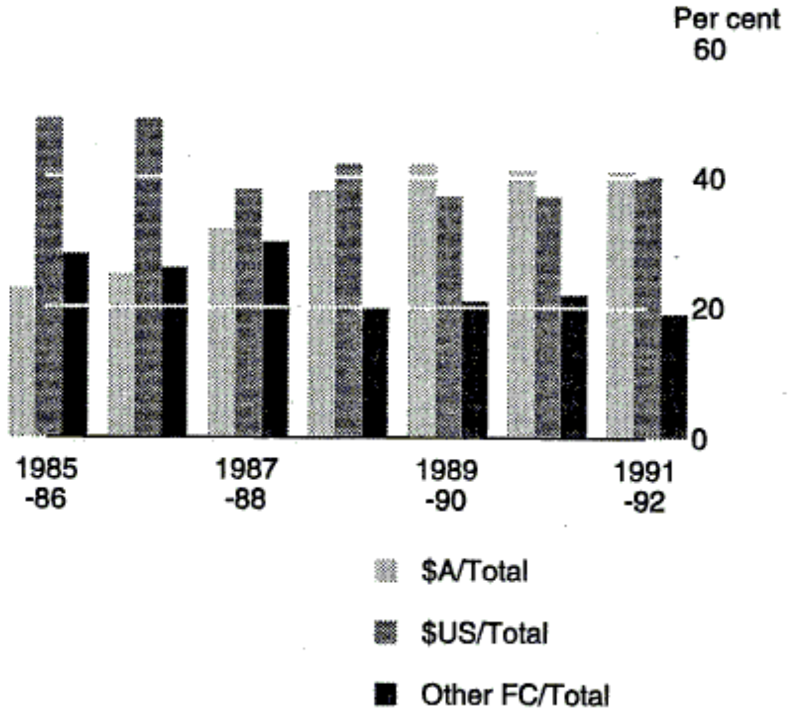


Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

Interest payable is affected by many factors, including the level of debt financing, the relative attractiveness of debt versus equity, different interest rates available overseas compared with those prevailing in Australia, and the currencies in which borrowing is denominated. In Australia’s period of high inflation, interest rates were high, leading to enterprises borrowing from abroad, where interest rates were comparatively lower. In turn, this resulted in a rise in foreign debt and consequently a rise in interest payable abroad. However, low inflation and falling interest rates in recent years helped negate this impact.

As different foreign currencies have different interest rates, changes in the currency composition of Australia’s net foreign debt will affect the amount of net interest payable on that debt. Graph 6 shows the percentage of foreign borrowing denominated in Australian dollars, US dollars and other currencies. At 30 June 1992, 59 per cent of foreign borrowing was denominated in foreign currency, and two-thirds of that was denominated in US dollars. The different interest rates underlying this range of currencies will impact on the level of interest payable and the extent of the impact will vary as these rates change and as the currency composition of debt changes. The proportion of Australia’s foreign debt denominated in Australian dollars grew steadily over the period 1985-86 to 1991-92 (a consistent time series for currency data is available from 30 June 1986), from 23 percent to 41 percent.

GRAPH 6. FOREIGN BORROWING BY CURRENCY, AT END OF YEAR

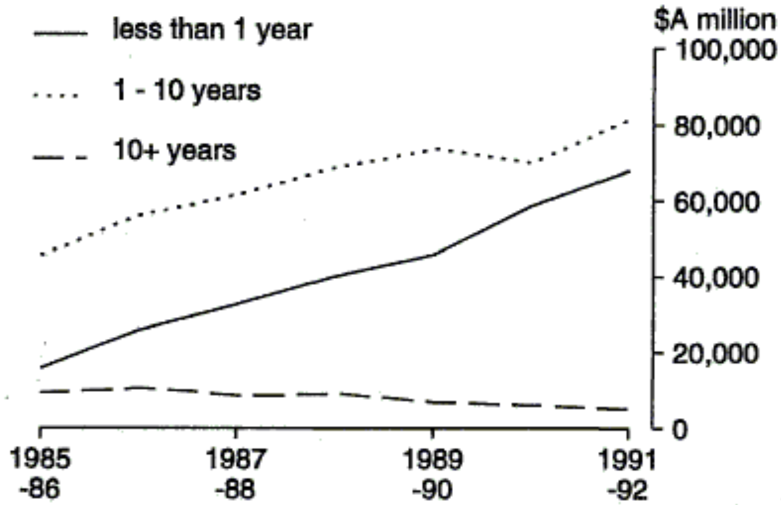


Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

The maturity structure of foreign borrowing also changed over time. In the years of high inflation and high interest rates in the 1980s, investors preferred borrowing at call within a year or with short contractual terms so that they were not locked into long term commitments. While inflation in Australia had fallen by the end of 1991-92, Australian interest rates remained high in relation to those prevailing in the rest of the world and the trend towards short term borrowing continued.

Graph 7 shows that the value of foreign borrowing with terms of more than ten years declined slowly over the period 1985-86 to 1991-92 (the period for which maturity data are available). In contrast, debt with a term of less than one year rose steeply. At 30 June 1986, the value of foreign borrowing outstanding with a contractual maturity of one year or less was $15,871 million (22 per cent of foreign borrowing domiciled abroad). By 30 June 1992, this had reached $67,939 million (44 per cent of foreign borrowing domiciled abroad).

GRAPH 7. FOREIGN BORROWING DOMICILED ABROAD (a) MATURITY OF LEVELS OUTSTANDING, AT END OF YEAR



(a) Borrowing domiciled abroad refers to borrowing raised on foreign capital markets (rather than in Australia).
Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

COMPOSITION OF AUSTRALIAN BORROWING

By Country

The main countries to whom foreign borrowing is owed are the USA, Japan, the UK, the ASEAN countries, Switzerland and the international capital markets (the category used for securities issued on several markets at once, e.g. Eurobonds). These account for 78 per cent of all foreign borrowing domiciled abroad at 30 June 1992. The main sources of funds have changed over time. It can be seen in Table 3 that the relative importance of both the USA and the UK declined by about half over the period 30 June 1978 to 30 June 1992, while the proportion of debt owed to Japan trebled. Capital raisings on international capital markets more than trebled over the period 30 June 1985 to 30 June 1992.

TABLE 3. PERCENTAGE SHARE OF TOTAL FOREIGN BORROWING IN AUSTRALIA BY COUNTRY OF CREDITOR

	30 June 1978	30 June 1985	30 June 1992
USA	31	21	15
UK	24	16	10
Japan	7	18	21
Switzerland	5	4	2
ASEAN	2	13	3
International capital markets	na	7	27
Other (including unallocated)	32	21	21
na = not available			

Source: cat. nos 5305.0 (annual data) & 5306.0 (quarterly data).

By Currency

Changes in the exchange rate also affect the level of net foreign debt. When the exchange rate deteriorates, the amount of foreign borrowing, converted to Australian dollars, increases. Although

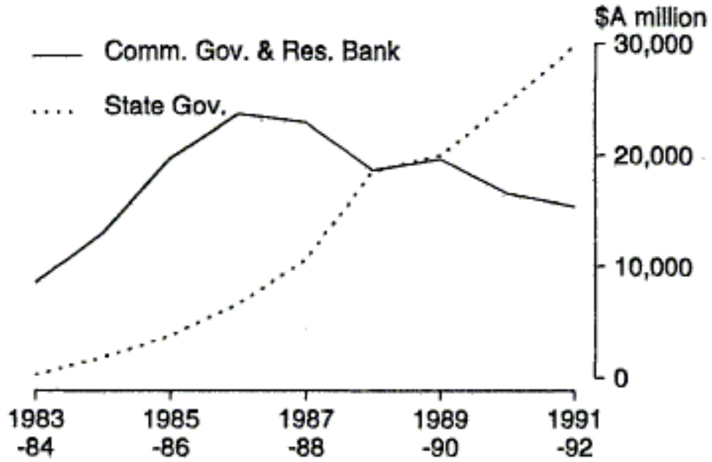
the Australian dollar value of Australian lending abroad and reserve assets is also affected by exchange rate variations, it will be affected differently due to the different currency composition of foreign borrowing and lending and reserve assets. It can be seen in Table 1 that in the years 1984-85, 1987-88 and 1990-91, exchange rate movements represented a significant proportion of the change in the level of debt. This coincided with the marked depreciations (1984-85 and 1990-91) and appreciations (1987-88) of the Australian dollar against other currencies. Overall, exchange rate movements contributed $10,491 million to the change in the level of net foreign debt from 30 June 1984 to 30 June 1992 (see Table 1).

By Sector

The proportions of foreign borrowing attributable to the official and non-official sectors changed very little over time. The official sector, comprising General Government institutions and the Reserve Bank, increased its share of borrowings from 23 per cent ($1,403 million) at 30 June 1976 to 24 per cent ($45,290 million) at 30 June 1992. However, within this category the relative importance of "Commonwealth" and "State" governments was reversed. At 30 June 1984 the relative proportions were 96 per cent and 4 per cent respectively but by 30 June 1992 the proportions were 34 per cent and 66 per cent. This largely reflects:

- net repayments of $8,254 million of debt domiciled abroad by the Commonwealth Government over the years 1986-87 to 1991-92, compared to net drawdowns of $23,182 million by State Governments over the same period.; and
- the agreement at the June 1990 Loan Council meeting that the States and Territories would in future borrow on their own account rather than have the Commonwealth Government borrow on their behalf.

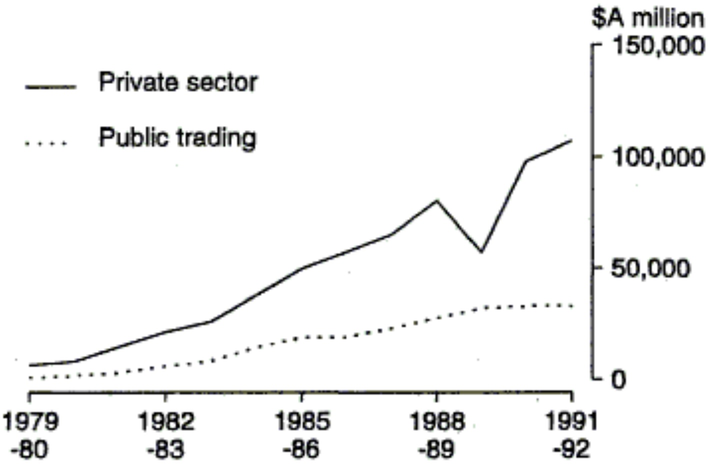
GRAPH 8. LEVELS OF OFFICIAL SECTOR BORROWING, AT END OF YEAR



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

In the non-official sector, public trading and financial enterprises accounted for 18 per cent ($33,156 million) of total foreign borrowings at 30 June 1992 while the private sector accounted for 58 per cent ($107,351 million). This compares with shares of 11 per cent ($1,497 million) and 47 per cent ($6,314 million) respectively at 30 June 1980 (data only being available from 1980).

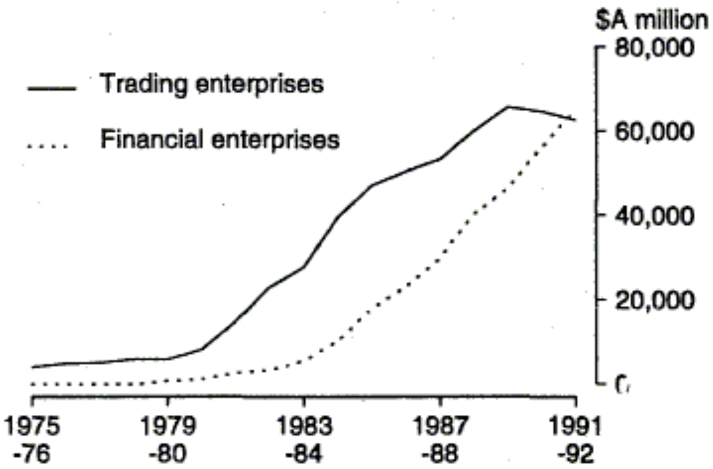
GRAPH 9. LEVELS OF NON-OFFICIAL SECTOR BORROWING, AT END OF YEAR



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

Financial enterprises and trading enterprises have had different impacts on net foreign debt. The net foreign debt of trading enterprises declined for the first time during the period of this study from a high of $65,764 million at 30 June 1990 to $62,591 million at 30 June 1992. Financial enterprises continued to expand their levels of net foreign debt (by 14 per cent in 1989-90, 21 per cent in 1990-91, and 16 per cent in 1991-92) to reach a level of $65,212 million at 30 June 1992. This differing pattern reflected in part the shakeout in the trading enterprises sector in the late 1980s and early 1990s when assets were sold and the proceeds were used to repay debt. In addition, trading enterprises refinanced locally as domestic interest rates fell, while financial enterprises continued to source funds for on-lending from offshore.

GRAPH 10. FINANCIAL AND TRADING ENTERPRISES NET NON-OFFICIAL FOREIGN DEBT



Source: ABS 5305.0 Annual data, 5306.0 Quarterly data

INTERNATIONAL COMPARISONS

It is not possible to make reliable international comparisons of foreign debt. There are major data gaps and inconsistencies between countries. Even the terms “gross debt” and “net debt” can be highly misleading as different countries use various criteria for determining what is and is not, included in measures of debt. Differences in coverage and valuation also limit international comparability of foreign debt statistics. For example, New Zealand does not include domestically issued securities held by non-residents in its debt statistics. In addition, most countries still collect data on a book value basis, while Australia collects data on a market value basis in accordance with internationally agreed principles.

CONCLUSION

Australia’s net foreign debt increased steadily over the period of this study and reached $150,050 million at 30 June 1992 . Although exchange rate variations contributed to the increase, net new borrowings were consistently the main component of the increase in net foreign debt. The official sector accounted for only a small part of these borrowings - the majority of borrowings were by private trading enterprises, sourced mainly from the USA, UK, Japan and international capital markets. The ratio of net foreign debt to GDP rose from 3.1 per cent at 30 June 1976 to 39.0 per cent at 30 June 1992.

This feature article was contributed by Jane Griffin-Warwicke, ABS.

For more information

The data used in this article are mainly from the annual publication International Investment Position: Australia (cat. no. 5305.0) and the quarterly publication International Investment Position: Australia (cat. no. 5306.0).

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